

# TRUSTEE DUTIES

Dr Andrew Butler, Russell McVeagh

Notes...

**Lindsay:** I'm pleased to introduce Dr Andrew Butler a Partner of the law firm Russell McVeagh in Wellington. Andrew's a litigator with extensive experience across a number of areas of the law including public law, policy, human rights protection, trusts and equity. He's the general editor of Equity & Trusts in New Zealand and a member of the Trusts Reference Group which assisted the New Zealand Law Commission with their review of the law of trusts.

Andrew, can you please tell us how trustee duties come about and take us through some examples?

**Andrew Butler:** Thanks Lindsay. Good to be here. The best place to start is to remember that a trust isn't like a company, so it's not an "entity" in and of itself as a company is. A trust is a relationship between trustees in whose name property is held or dealt with (there always has to be some sort of property), and people called beneficiaries (the people who are intended to enjoy the benefits of that property).

In a trust, the trust property (i.e. the trust assets) is held in the name of the trustees, not the name of the trust. In other words, if the trust owned shares or land and you searched the company register for the shares or the Land Register for land, you would see the trustees recorded as the owners.

So that's the starting point, to very importantly understand and realise that a trust is essentially a relationship of trust between the trustees, the beneficiaries and an item of property.

The next thing to bear in mind is that if you're a trust beneficiary, there's an element of vulnerability because the trust property in which you have a beneficial interest, isn't held in your name. It's held in the name of somebody else, the trustee. There's always the potential risk of a trustee running off with the property and doing other things with it that aren't necessarily in your interest.

So what the law has done (and it's a particular branch of the law called the Law of Equity), is recognise that vulnerability and say to trustees "you've got particular duties of loyalty that you owe to your beneficiaries and we will police those duties very carefully". So that's the first part of the relationship, trustees have duties of loyalty to beneficiaries which are also known as fiduciary duties.

The second aspect which the Law of Equity has imposed on trustees, are just plain ordinary duties of care. With duties of care, we're talking about trustees having to properly manage trust property and not to

take overt risks with it. Trustees just can't just do whatever they like with trust property; they have to manage it prudently and well. That's in contrast to the way the law ordinarily works when you own property in your own name and you can pretty much do what you like with it.

The third important aspect in the overall trust relationship is that a trustee only has the power and authority they are given by the trust deed. In other words, even if a trustee thinks something might be a good idea (for example, to invest trust money in a certain way), then unless the trust deed allows them to do that, or unless the law otherwise permits them to do that, then they can't do it. Obeying your trust deed is an absolutely critical aspect of your duty as a trustee.

**Lindsay:** So to summarise, a trust is a relationship between trustees and beneficiaries and involves property. Next, trustees have three broad duties – duties of loyalty, prudence and to obey the trust deed. A trust really is a relationship of trust and confidence...

**Andrew:** That's a good way of putting it Lindsay. When you're a trustee, the trust property isn't yours, it's somebody else's. So, while it's perfectly possible for someone to be both a trustee and a beneficiary of the same trust, when they're acting as a trustee in that position, they still have got to have regard to the interests of all the other beneficiaries of the trust.

Now, we've just talked about the broad categories of trustee duties – the fiduciary duties, the duties of prudence and duties to obey the trust deed. What the law has then done is break down those broad categories into sub-rules to give better effect to the principles behind those broad categories.

Let's look at the duty of loyalty. The Law of Equity has put very strict rules in place which effectively prevent trustees from benefiting themselves when they are holding the office of trustee. For example, trustee work is intended to be entirely voluntary, so unless the trust deed allows for it, trustees can't pay themselves anything for the work they do on behalf of the trust. Many trustees aren't aware of that so it always comes back to the duty to obey the terms of the trust deed.

Other related examples of the duty of loyalty is the duty not to favour yourself as trustee over the interests of the beneficiaries and a duty to be impartial between beneficiaries, or in other words, not favour one beneficiary over another.

It's very important to stress that these rules are subject to the facts and the circumstances of the particular trust and the terms of each particular trust deed. Some trust deeds may allow the trustees to charge for their services, or to favour one set of beneficiaries over another to a degree.

However, unless the trust deed allows it, the law says that as a matter of general principle, trustees owe the duty of loyalty equally to all beneficiaries.

**Lindsay:** A lot of non-professional trustees I speak to wouldn't properly understand the duties or obligations you've been describing or some of the powers and discretions in their trust deed...

**Andrew:** Let's pick up on your point about trustees having powers and discretions and acting in accordance with the trust deed. Another trap for trustees is where a trustee might look at the trust deed and see a clause with a power authorising them to do something. All that power does is "authorise" a particular action to take place and the fact that a trustee is "authorised" to do something, does not mean exercising that power in any particular case is the right thing to do.

Let's take an example. Say you're a trustee holding some land that you want to develop and you think it would be good to plant it in kiwifruit. You look at the trust deed and see a clause that gives you power to invest trust monies in "fruit growing orchards" or something of the sort and you think "that means I can invest in an orchard, so I can do that".

The first part is correct. Yes, you're allowed to invest in an orchard but whether you should do that is not determined by whether you have the power to do it. Whether you should is determined by whether it's prudent in all the circumstances to do that. Before making a decision to go ahead, a prudent trustee would need to assess the marketplace, work out if there were good returns on kiwifruit, understand if it was the best use of the land, think about what costs could be involved, consider other options available, clarify what beneficiary needs there were (for example, would they be putting the interests of beneficiaries who may depend on income at risk?), those sorts of things.

So, having the power in the first place is a minimum requirement. If you act without having the power as trustee, you're acting illegally. Then, once you know if you've got the power, you then need to work out should you do it? Trustee decisions can always be vulnerable to attack if they aren't considered to be prudent and or if they don't meet the loyalty requirements. The overriding duties of loyalty and duties of prudence are both critical to understanding your job as a trustee.

**Lindsay:** Trustees have a lot to think about. What other duties would you like to touch on?

**Andrew:** It's always a tragedy to see trustees get caught out when they breach their duties. There are words of warning coming through from case law for people who might be regarded as silent or passive trustees (referring to trustees of family trusts who sit back and are not actively involved in the management of the trust). The Courts have been clear in saying there is no such thing.

Trustees are required to act unanimously (unless their trust deed allows otherwise) and be active in their stewardship of the trust. If a trustee is really only just "lending their name" as a trustee of a trust, or simply doing what they're told by their fellow trustees, or not paying attention to the affairs of the trust, then the best thing for the trustee to do is get out of being a trustee. If I can put it this way ... the pain of silence can be quite significant!

**Lindsay:** I note the Law Commission issued its Review of the Law of Trusts in August 2013 which included recommendations for changes around trustee duties. Can you comment on the changes?

**Andrew:** The review started in 2009 and was completed in 2013. The Law Commission recognised that many trustees don't properly understand what the trustee job is or what the role involves. In the modern age that's just not acceptable. The Commission has recommended a new Trusts Act and included very clear statements of what a trustee's mandatory and default duties are. I think that this is a very welcome development and one which will really help trustees.

**Lindsay:** The trustee duties we've been talking about aren't new and they've been developed over many years. The Law Commission has issued some very good information on trustee duties in their fourth issue's paper (available from their website [www.lawcom.govt.nz/project/review-law-trusts](http://www.lawcom.govt.nz/project/review-law-trusts))

**Andrew:** That's right. The Law Commission papers are very good resources for trustees and bring together the learning from all of the case law, some of which goes back four hundred years. As you can imagine, the Judges feel pretty comfortable they've got it right after having worked on it for four hundred years and that's why they're pretty uncompromising when it comes to trustees duties. As far as the Courts are concerned, being a trustee is a serious office and you don't want to appear in front of a Judge saying "I didn't really understand".

**Lindsay:** Andrew, you touched on trustees breaching their duties, can you take us through that?

**Andrew:** A breach of trust can occur if a trustee violates any of the three major category rules that I mentioned earlier – if they breach their duty of loyalty, their duty of prudence or their duty to act in accordance with the terms of the trust deed, or trust law in general.

If a breach of trust is identified, the Courts will require the trustee to make good any loss that flows from that breach of trust.

Let's take another example, say a trustee misinterprets the trust deed and pays trust monies to a person thinking they were a beneficiary and entitled to receive that money and it turns out they weren't. It is the trustee who has the obligation to replenish the trust fund for the amount of the distribution that's been made in breach of trust. The Court will order that regardless of the means of the trustee and typically, regardless of the good faith or otherwise of the trustee in doing so.

Now there are some exceptions and a bit of leeway, but generally speaking, the starting point has got to be that's a breach of trust and the trustee has the obligation to make good any loss. Similarly, let's say as a trustee you made a bad investment. If we use the kiwifruit orchard example we talked about earlier and say that it turns out to be an unmitigated disaster as an investment. If the beneficiaries make a successful breach of trust claim against the trustees and the Courts agree that the investment in a kiwi fruit orchard was imprudent, the trustees will have to make good the loss.

In the area of prudence, the good news is that the Judges are clear that trustees are not expected to be the insurers for the trust funds and as long as an investment is considered prudent, trustees don't have to make good any loss. However, if the Courts consider an investment was imprudent (which they might do if you had "put all the trust money into that one basket"), then the trustees have got to make good any losses that flow from their poor decision. It's quite a sobering thing to remember.

**Lindsay:** What other areas do trustees run into problems?

**Andrew:** An area I have seen some problems is around decision-making. Trustees often get advice from advisers to help them make good decisions. Examples could be where a trustee asks an investment adviser to recommend an investment strategy or where advice is sought from solicitors and accountants. Drawing on the skill and expertise of appropriate professionals is entirely legitimate.

However, where trustees can sometimes go wrong is in basically delegating their decision-making functions to some other person (for example, to the adviser). Unless the trust deed authorises them to delegate decisions, trustees are not allowed to delegate their decision-making to somebody else.

It is the trustees who are entrusted with making the core decisions on behalf of the beneficiaries and if a trustee doesn't feel competent to make a decision, then they really shouldn't be a trustee or they should

be looking to amend the trust deed to allow them to delegate as much as possible.

**Lindsay:** Trustees really are in a “decision making” role.

**Andrew:** Very much so. At the end of the day, the trust property is vested in the trustees name, they’re the ones entrusted with its care and management and responsibility sits with them. The Courts simply will not be very forgiving of trustees who say “I didn’t know” or “this is way beyond me” or “this was very hard so I decided to give it to somebody else”.

**Lindsay:** Do you have any final comments on good practices for trustees around their duties?

**Andrew:** Firstly, I think people need to actually realise how serious the trustee job is. There’s a degree of casualness among some trustees and they need to think of being a trustee as a job –understanding their duties, knowing what they’re responsible for and reviewing their performance.

They have to understand the obligations that sit with being a trustee and know what it could mean for them personally, if things do go wrong (for example, their own house or assets could be on the line). If you’re tempted to take on the trustee role as a favour for somebody else, get some good advice and understand how you can best protect yourself or reduce your risk of personal liability.

Finally, I just want to emphasise that the points I’ve made in this interview are the general position. It’s possible for many of the rules I’ve mentioned to be, in effect, overridden by the terms of a trust deed (for example, most trust deeds permit trustees to be paid a fee for performing their services, many trust deeds permit trustees to delegate matters to other people, other trust deeds authorise the trustees to prefer one group of beneficiaries over another).

As always with these things, the general principle has to be applied to the particular circumstances and facts of the case and any particular scenario will often be a blend of the general principles, the terms of the particular trust deed and the particular circumstances confronting trustees as they arise

**Lindsay:** Andrew, thank you for giving us that overview of the duties and job of being a trustee and your recommendations for what trustees need to be thinking about. Andrew, if someone wants to make contact with you, they can do that through your website [www.russellmcveagh.com](http://www.russellmcveagh.com).